

- A. No. A call from an ILEC customer to an ISP served by ICG is functionally identical to a call from an ILEC customer to an ordinary business customer served by ICG.¹² From the originating to the terminating switch, both calls use the same path and the same equipment to reach their destinations. More importantly, the costs to deliver the calls made to the ordinary business customer and the ISP customer are the same. For this reason, the rates associated with recovering those costs should likewise be the same. There is simply no justification to single out the call delivered to the ISP and suggest that no compensation (or reduced compensation) should be paid to the carrier which delivers the call, while a different (presumably cost-based) rate is applied to other calls with identical technical and cost characteristics. The purpose of inter-carrier compensation is to permit the carrier that receives and delivers calls originated by the end user customer of another carrier to recover its costs of doing so. If the costs don't change according to the nature or identity of the called party, there is no justification for changing the rate (especially if that change is to arbitrarily make the rate zero for certain "end users").
- Q. HAVE THE ILECS RECOGNIZED THAT CALLS DELIVERED TO AN ISP ARE FUNCTIONALLY NO DIFFERENT THAN CALLS DELIVERED TO A VOICE CUSTOMER?

¹² For all purposes related to reciprocal compensation, the ISP *is* an ordinary business customer of ICG.

- A. Yes. In response to ICG's Data Request No. 12, Pacific Bell states that it "does not contend that there are differences in the call processing performed by the Pacific end office switch" to terminate a call to a POTS user or a dial-up call to an ISP.¹³

I agree with Pacific Bell's conclusion in this regard: there is no difference in the call processing. The cost drivers that determine the cost to a carrier of delivering a call are the same whether the customer to which the call is delivered is an ISP or any other local customer. The fact that the customer to whom the call is delivered is an ISP is not a cost driver.

As a result, the ILEC's proposal to split the market by segregating out calls delivered to ISPs for separate rate treatment is unsupported by the conclusion of Pacific Bell that there are no differences in call processing. Market splitting with no cost basis is not an effort to develop cost-based rates, it is merely an attempt to engage in anti-competitive behavior.

- Q. HAVE WITNESSES FOR PACIFIC BELL SISTER COMPANIES IN OTHER STATES PRESENTED TESTIMONY THAT DEMONSTRATES THAT CALLS DELIVERED TO AN ISP ARE FUNCTIONALLY NO DIFFERENT THAN CALLS DELIVERED TO A VOICE CUSTOMER?

¹³ GTEC objected to and did not respond to this request.

- A. Yes. In Texas, Southwestern Bell presented the direct testimony of Mr. Robert Jayroe, which included a series of network diagrams designed to show call processing. Mr. Jayroe's Figures 1 and 2 are attached as exhibit DJW-2.

In Figure 1, Mr. Jayroe shows a local call, for which he concedes "there is no dispute that this call, if made between SWBT and a CLEC, would be subject to reciprocal compensation" (Direct Testimony, p. 3). Mr. Jayroe's diagram depicts a call flow from the calling party's telephone, via a local loop to the originating end office, via an interoffice trunk to a local tandem, via an interoffice trunk to the terminating end office, and via a local loop to the called party. While he used telephone icons in his diagram, I can only assume that Mr. Jayroe has not intended to limit his definition of a local call to voice calls only, and would not object to the substitution of a computer at either the calling party's or called party's location (or both). Local data calls certainly do exist and there should likewise be "no dispute" that such a call would be subject to reciprocal compensation.

Mr. Jayroe's Figure 2 purports to show a call to an ISP. As he correctly points out, "the end user dials either a 7 or 10-digit number and the call is transmitted to an end office in the same local exchange just as Figure 1 depicts." An important observation can be made with regard to Mr. Jayroe's Figures 1 and 2: the Figures are identical in all relevant respects. Reciprocal compensation is designed to permit the recovery of switching and transport costs associated with delivering a call. *The switching and*

transport elements are identical in Mr. Jayroe's Figures 1 and 2. Reciprocal compensation is not intended to permit recovery of the cost of the loop between the terminating end office and the called party in Figure 1, and likewise is not intended to address any portion of Figure 2 beyond the terminating end office. Reciprocal compensation is designed to permit the recovery of transport and switching costs, and as Mr. Jayroe's illustrations make clear, the transport and switching elements of the call do not change when the called party is an ISP. The portions of Figures 1 and 2 related to the elements of reciprocal compensation are the same in both cases. More importantly, the costs represented by these identical portions of Figures 1 and 2 are likewise identical, eliminating any cost basis for a different rate based on the identity of the called party as an ISP.

Q. FACTUAL ISSUE 4 ALSO ASKS FOR TESTIMONY ADDRESSING ANY RELEVANT DIFFERENCES BETWEEN ILEC AND CLC COSTS FOR THE DELIVERY OF ISP-BOUND TRAFFIC. DO ANY COST DIFFERENCES EXIST THAT IMPACT THE APPROPRIATE RATE STRUCTURE FOR RECIPROCAL COMPENSATION?

A. No. At any given point in time, the cost to a CLC to deliver a local call originated by an end user of an ILEC may be higher or lower than the corresponding cost incurred by the ILEC. The objective of an appropriately designed reciprocal compensation mechanism is

to give both ILECs and CLCs the opportunity to recover these costs if they are operating efficiently.

The FCC rules mandate that rates for reciprocal compensation be symmetrical and based on the ILEC's costs calculated pursuant to TELRIC principles. Specifically, 47 C.F.R. § 51.711 (a) requires that "rates for transport and termination of local telecommunications traffic shall be symmetrical," and subpart (a) (1) clarifies that "symmetrical rates are rates that a carrier other than an incumbent LEC assesses upon an incumbent LEC for transport and termination of local telecommunications traffic equal to those that the incumbent LEC assesses upon the other carrier for the same services."

C.F.R. § 51.705 (a) requires that these symmetrical rates be established on the basis of:

- (1) the forward-looking economic costs of such offerings, using a cost study pursuant to §§ 51.505 and 51.511 of this part;
- (2) default proxies, as provided in § 51.707 of this part; or
- (3) a bill and keep arrangement, as provided in § 51.713 of this part.¹⁴

The FCC's decision to require reciprocal compensation rates at the level of the forward-looking (TELRIC) costs to the ILEC of the related Unbundled Network Elements ("UNEs") is economically sound. If reciprocal compensation rates are established at this level, the ILECs – if they are operating efficiently – will be able to

¹⁴ § 51.713 (b) permits a state commission to impose a bill and keep arrangement only if it determines that the flow of traffic between carriers is roughly balanced and expected to remain so.

recover the transport and switching costs that they incur to deliver a call to the called party. Likewise, a CLC – if it is operating as efficiently as the ILEC – will be able to recover its corresponding costs.

There are two equally important consequences of a rate structure for reciprocal compensation that is symmetrical and based on TELRIC costs. First, ILECs and CLCs will have the opportunity to recover the costs that they incur when performing a service for the end user customer (calling party) of another LEC (a customer from which they receive no revenue for providing local exchange service). The appropriateness of this cost recovery is not impacted by the identity of the called party. Second, both ILECs and CLCs should then be financially indifferent to the direction of the net flow of traffic. The costs incurred in additional reciprocal compensation will be offset by the costs avoided when the LEC that originates the call does not have to incur the cost of terminating it. This an important outcome of an appropriately designed reciprocal compensation mechanism: the total cost incurred by each LEC to deliver local calls will be the same, without regard to either the direction of the net flow of traffic or the identity of the calling or called parties.

Q. ON WHAT BASIS SHOULD THE APPLICABLE RECIPROCAL COMPENSATION RATE ELEMENTS BE DETERMINED?

A. The applicable rate reciprocal compensation may consist of the tandem switching, transport, and end office switching elements, or it may consist of only the transport and end office switching elements. The applicable elements should be determined based on the capability that is being provided by the LEC that receives and delivers the call to the LEC (and its customer) that originates the call.

Q. YOU STATED THAT THE RATES FOR RECIPROCAL COMPENSATION SHOULD REFLECT THE CAPABILITY BEING PROVIDED BY THE LEC THAT RECEIVES AND DELIVERS THE CALL. WHY IS THIS IMPORTANT?

A. When interconnected carriers accept traffic from each other for delivery, they are providing a specific and identifiable service: delivery of a call to a called party within a given geographic service area. The service being provided is not dependent on the network arrangement used by the carrier that delivers the call, however.

The ILEC networks are generally based on the old Bell System switching hierarchy: within a given geographic area, multiple end offices (Class 5s) subtend on tandem offices (Class 4s). These tandem offices aggregate traffic and network management functions associated with the area served by each of the end offices subtending it. The network of most CLCs, however, is built around a different design theory. In order to take advantage of the decreasing costs of transport relative to switching facilities and to efficiently implement switching capabilities now available,

CLCs have deployed switches (often with Class 4/5 capabilities) to serve geographic areas comparable to, and sometimes much larger than, the area served by the ILEC tandem.¹⁵

If a CLC interconnects with the ILEC at the ILEC tandem, it receives the capability to have calls delivered anywhere within the geographic area served by that tandem (tandem level termination or delivery). In exchange for this capability, it pays the ILEC the tandem interconnection rate (consisting of tandem switching, transport, and end office switching). If the CLC places or leases the facilities necessary to establish points of interconnection at the ILEC end offices, it will pay the lower end office interconnection rate, but will receive in return the capability to have calls delivered to the area served by that ILEC end office. The ILEC enjoys a somewhat different opportunity, however. By establishing a point of interconnection at the CLC switch, the ILEC receives the opportunity to have calls delivered to an area equal or greater than in size to the area served by its tandem. The capability received is directly comparable to tandem level delivery purchased by the CLC, and should be provided at the same rate.

As a matter of public policy, the mechanism for mutual and reciprocal compensation utilized should encourage both ILECs and CLCs to operate efficiently, and in no case should it penalize a carrier for operating more efficiently than its competitors to

¹⁵ It is interesting and instructive to note that some ILECs have begun to deploy Class 4/5 switches in order to realize these efficiencies. Nearly all of BellSouth's tandems, for example, are now provisioned as part of a Class 4/5 switch rather than on a stand-alone basis.

which it is interconnected. A reciprocal compensation mechanism that focuses on the underlying equipment used, rather than the functionality provided, would create such a penalty. If the ILEC interconnects with a CLC switch, it receives a capability that is equal to or greater than (in terms of the geographic area to which it now has access) to the capability that a CLC would receive by interconnecting at a ILEC tandem. As a result, the rate for reciprocal compensation should be equal in both cases to the ILEC tandem interconnection rate (as well as the terminating local switching rate of the ILEC).

If such a symmetrical rate is not applied (if the ILEC is permitted to interconnect with the CLC switch at the end office rate), several consequences inevitably result. First, the ILEC is getting something for nothing: it is receiving tandem interconnection at the end office price. Second, the CLC is being penalized for deploying a more efficient network arrangement. Under this scenario, a CLC would have to work to become as inefficient as the ILEC in order to receive truly mutual and reciprocal compensation. It could do so by deploying a more traditional – and considerably less efficient -- network consisting of independent tandems and multiple subtending end offices, but such a result is unlikely to be what Congress intended when it passed the Act.

A symmetrical form of reciprocal compensation avoids these pitfalls. If the ILEC interconnects at a CLC switch and receives the equivalent of tandem level capability (defined as the opportunity to have, from a single point of interconnection, calls delivered to a geographic area comparable to the area served by the ILEC tandem), it should pay

the tandem interconnection rate. If a CLC interconnects at the ILEC tandem and receives tandem level capability, it should likewise pay the tandem interconnection rate. In order to avoid paying the tandem rate, the CLC would need to invest in the facilities necessary to interconnect at each ILEC end office.

Q. HAS THE FCC REACHED CONCLUSIONS THAT ARE CONSISTENT WITH YOUR PROPOSAL TO HAVE THE RATE REFLECT THE CAPABILITY PROVIDED?

A. Yes. The most concise statement of this policy is provided in Rule 51.711. Part (a) (3) of this Rule states that “[w]here the switch of a carrier other than an incumbent LEC serves a geographic area comparable to the area served by the incumbent LEC’s tandem switch, the appropriate rate for the carrier other than the incumbent LEC is the incumbent LEC’s tandem interconnection rate.” As described above, the CLC switches in California typically have been placed to serve a geographic area that is equal to or greater than the area served by a comparable ILEC tandem. Requiring that the ILEC pay the tandem interconnection rate will ensure that it receives in exchange for its money a capability that is at least equal to, and sometimes greater than, what it is paying for. Meanwhile, both CLCs and ILECs will have the incentive to operate efficiently, and CLCs will not be penalized for utilizing a more efficient network design.

July 14, 2000

Q. IF A LEC IS ABLE TO REDUCE ITS COSTS OF CALL DELIVERY AFTER A RECIPROCAL COMPENSATION RATE HAS BEEN ESTABLISHED, WILL IT RECEIVE A "WINDFALL" FROM RECIPROCAL COMPENSATION PAYMENTS?

A. No. There are both conceptual and practical reasons why such a "windfall" will not be created.

First, a cost-based rate may need to be adjusted over time in order to accurately reflect ongoing changes (increases or decreases) in the forward-looking cost of providing the service in question. The trade-off involves accuracy and administrative reality: while forward-looking costs may change over relatively short periods of time, it is not practical to adjust the rates on a continuous basis. Of course, this trade-off is not unique to the rates for reciprocal compensation; the rate for the UNEs provided by the ILECs, including but not limited to the transport and switching elements that make up reciprocal compensation, may need to be changed upward or downward to reflect ongoing changes in the forward-looking cost of providing those elements. The practical limitations of rate regulation mean that the costs experienced by both ILECs and CLCs may be higher or lower than the established "cost-based" rate. Reciprocal compensation rates should be reviewed (and adjusted up or down if necessary) at the same time that ILEC UNE rates are reviewed and adjusted, if the Commission concludes that such an adjustment is necessary.

Second, cost-based rates for reciprocal compensation, subject to the periodic adjustments described above, closely emulate the incentives created in a competitive marketplace. Both ILECs and CLCs have the incentive to invest in new technologies and continuously seek ways to provide quality services at a reduced cost. To the extent they are successful in doing so, they will be rewarded for their efforts until the next rate adjustment. This mechanism is directly comparable to the operation of competitive markets: competing firms seek to reduce cost and increase efficiency. If they are successful, they will be rewarded with higher returns for the period of time that it takes their competitors to "catch up" with their cost saving measures. Of course, competing firms may also forego these increased returns in favor of a competitive price advantage for the period of time in which they have a cost advantage, in hopes of increasing market share. Either way, the firm making the effort to reduce costs receives a benefit for a limited but definite period of time.

The converse is also true, however: a mechanism (regulatory or market) that prevents firms from achieving any benefit from cost reductions will eliminate the incentive for the firm to engage in the efforts to make the cost reductions. Firms will not incur the risk of investing in new technologies, or engage in the belt tightening necessary to reduce costs through other means, if there is no benefit to doing so. It is important to recognize that both ILECs and CLCs share this opportunity: both can engage in the activities necessary to reduce cost while a given set of rates is in effect.

Q. ARE THERE ADDITIONAL REASONS TO BELIEVE THAT CLCS WILL NOT RECEIVE A “WINDFALL” FROM RECIPROCAL COMPENSATION RATES?

A. Yes. It is important to remember that the ILECs began the era of local competition with at least two significant advantages: they owned a fully built, ubiquitous network (paid for in large part by ratepayers), and they began with essentially 100% of the customer base (and therefore 100% of the network traffic). In direct contrast, CLCs have had to invest in network facilities (and have had to attract the capital necessary to make such investments), and have had to work aggressively to attract customers to their network in order to realize any applicable economies of scale or scope.

Investment in the components of a telecommunications network, especially switching facilities, tends to be “lumpy” in nature. To an incumbent ILEC, the investment in such equipment carries relatively little risk, because an existing customer base stands ready to utilize that equipment. For a CLC, however, such an investment – while necessary – carries significant risk. The CLC must attract sufficient usage to its network in order to reduce the per-unit cost of switching to competitive levels. It is possible (and even likely) that, at this point in the development of the market for competitive local exchange services, the per-unit costs of switching experienced by the CLCs remains higher than that experienced by the ILECs in most of their end offices. Even with a more efficient network configuration, CLCs must win the race to attract

usage to their networks if they are to successfully compete over the long term.

While CLCs are working to increase usage on their networks in order to achieve economies of scale and scope comparable to the ILECs,¹⁶ it is likely that their per-unit costs of switching have not been reduced to levels below that of the ILECs (and therefore below that represented by the existing rates for reciprocal compensation). Clearly, if the costs incurred by the CLCs have not fallen to the levels represented by the ILEC's TELRIC costs, no "windfall" can be generated by reciprocal compensation rates.

Q. FACTUAL ISSUE 9 SEEKS INFORMATION ON THE IMPACT THAT THE USE OF NEW GENERATION TECHNOLOGY BY LECs WILL HAVE ON THE APPROPRIATE MECHANISM FOR RECIPROCAL COMPENSATION. DOES THE EXPECTED USE OF NEW TECHNOLOGY BY ILECS AND CLCS IMPACT YOUR PROPOSAL?

A. No. As described above, both ILECs and CLCs can be expected to invest in new technologies in order to reduce costs and provide new and higher quality service to customers. All LECs will have both the incentive and the opportunity to invest in new technologies where a business case can be made for doing so. Benefits will accrue to the LEC making the investment, as they would in a competitive market.

¹⁶ Efforts by CLCs to provide service to ISPs and other high volume customers are an expected part of this larger effort to increase total traffic volume as quickly as possible.

There is no reason to expect, however, that all LECs will make the same decisions regarding network design or the deployment of new technologies. Under the existing regulatory construct, it is reasonable to expect different LECs to have different network designs that rely on different technologies. The network of each LEC -- both ILECs and CLCs -- is a function of the decisions that it makes over time regarding the best means of providing a chosen array of services at the level of quality and efficiency demanded by the market. CLCs, who began doing business with no embedded network and no embedded customer base, have deployed networks that represent their assessment of the best means of providing service to a given geographic area. As a result, CLCs and ILECs typically have different network designs today. Over time, however, all LECs face the same challenge of managing their networks in order to provide the level of quality and efficiency that their customers (and potential customers) require.

In summary, the availability and subsequent deployment of new technologies can be expected to impact the cost of certain network functions over time. As the ILECs' UNE rates are periodically investigated and adjusted (if found to be necessary), it is appropriate, pursuant to the FCC's TELRIC principles, to consider the impact of certain of these new technologies. Once rates for network elements have been established (including the rates for reciprocal compensation based on those element rates), however, the fact that new technologies are being utilized by both ILECs and CLCs to provide

service does not impact the operation of an appropriate reciprocal compensation mechanism.

Q. FACTUAL ISSUE 10 CONCERNS COMPETITIVE AND FINANCIAL IMPACTS FOR VARIOUS ENTITIES. WHAT ARE THE COMPETITIVE CONSEQUENCES FOR THE ISP INDUSTRY OF APPLYING RECIPROCAL COMPENSATION FOR ISP-BOUND TRAFFIC?

A. If reciprocal compensation continues to be applied to calls made to ISPs, ISPs will continue to have competitive alternatives for the local exchange service that is crucial to their businesses. Providers of Internet services can be expected to continue to compete vigorously for end user customers, and the price and quality of the service that they receive from the LEC that they have chosen will continue to be an integral part of the price and quality of the service the ISPs then provide to their customers.

In contrast, if reciprocal compensation payments are arbitrarily reduced or eliminated for certain calls merely because the called party is an ISP, ISPs will have fewer and fewer competitive alternatives for local exchange service. Since no LEC, whether an ILEC or a CLC, would be able to recover its costs of delivering a call to the ISP if the call is originated by customers of another LEC, the incentive to provide quality service at a competitive price to ISPs would effectively disappear overnight. ISPs, and

the service they provide, would be materially impacted. This impact will of course extend to ISP customers, the end users of Internet access services.

Q. WHAT ARE THE COMPETITIVE CONSEQUENCES FOR THE END USERS OF ISP SERVICES OF APPLYING RECIPROCAL COMPENSATION FOR ISP-BOUND TRAFFIC?

A. The application of reciprocal compensation to calls in which the called party is an ISP is essential to the continued provision of high quality services to the end users of ISP-provided services.

The segregation of calls to ISPs for separate reciprocal compensation rate treatment would harm consumers. Because the quality and price of the local exchange service utilized by ISPs to permit their customers to reach them lies at the heart of their service offering, a change in the willingness of LECs to compete for ISP customers will have a direct impact of the consumers of ISP-provided services.

When all of the economic impacts are taken into account, the best means of protecting the interests of the ISPs' end user customers -- residence and business customers who utilize the Internet in an increasing number of aspects of their daily lives -- is to keep the current reciprocal compensation mechanism in place. The existing mechanism will help to ensure that an array of Internet access options are available to all Californians.

Q. WHAT ARE THE COMPETITIVE AND FINANCIAL CONSEQUENCES FOR CLCS OF APPLYING RECIPROCAL COMPENSATION FOR ISP-BOUND TRAFFIC?

A. The application of reciprocal compensation to all local calls, including those for which the called party is an ISP, will permit CLCs (and ILECs) to recover the costs that they incur when delivering traffic to the destination chosen by the customer of another LEC. CLCs will continue to have the incentive to offer service in response to the needs of all of their customers, including ISPs.

If reciprocal compensation is reduced or eliminated for calls to ISPs, the ability of CLCs to recover the costs that they incur will likewise be reduced or eliminated. The arbitrary segregation of ISP customers for disparate rate treatment has a further impact on CLCs and their ability to provide service to all customers, including but not limited to ISPs. In order to compete as a facilities-based carrier, a CLC must invest in facilities. The availability of capital is nearly always a direct function of the CLC's demonstrated ability to generate revenues with that investment. In addition, CLCs face the challenge of generating sufficient traffic volumes so that large fixed investments can be fully utilized and economies of scale comparable to those enjoyed by the ILEC can be reached.

For these reasons, ISPs have represented, and will continue to represent, an important market segment for CLCs. Eliminating the ability of a CLC to recover the

costs associated with delivering traffic to ISPs will have a significant impact on the CLCs' cost of doing business (at least with regard to volume-sensitive network elements such as switching) and is likely to distort one of the only local exchange market segments that appears to be well on its way toward effective competition. CLCs, like ICG, have been successful attracting ISP customers because, unlike most ILECs, CLCs have been willing and able to work to meet the ISP's unique service needs. Meeting the needs of customers is, after all, the essence of competition. If end user customers of the ILECs are permitted (as they must be) to direct calls to the ISP customers of the CLCs, and the CLC is not compensated for receiving and delivering those calls pursuant to the calling party's direction, the CLC is effectively penalized for attracting customers through innovative and customer service-focused products. A mechanism for systematically penalizing customer service and responsiveness is not a pro-competitive policy and clearly should be avoided at all cost.

Q. WHAT ARE THE COMPETITIVE AND FINANCIAL CONSEQUENCES FOR ILECS OF APPLYING RECIPROCAL COMPENSATION FOR ISP-BOUND TRAFFIC?

A. If the rates for the underlying UNEs, such as switching and transport, have been set at the level of the ILEC's TELRIC, a rationally operated ILEC should be indifferent to whether calls to ISPs (or any other category of customer) are included in or excluded from the scope of calls subject to reciprocal compensation.

Rates for reciprocal compensation that reflect the economic costs incurred by the ILEC should cause the ILEC to be indifferent to a choice of delivering the call to the called party itself or to handing the call off to a CLC for delivery (and paying the cost-based compensation rate). The ILEC will experience no better or worse outcome either way: if the ILEC terminates the call on its own network, it avoids paying the reciprocal compensation but incurs the cost of completing the call; if the ILEC hands the call off to a CLC for delivery to the called party it must pay reciprocal compensation but avoids the cost of completing the call on its own network. It is important to note, however, that a requirement that *all calls* originated by an end user customer of an ILEC and presented to a CLC for delivery be subject to reciprocal compensation is the *only* arrangement that will lead to this desired outcome. If an ILEC is successful in its efforts to exclude calls to certain CLC customers from the compensation arrangement, it will no longer be indifferent.

The ISP customers of the CLC can serve to illustrate this point, but the same problem would be created for any excluded customer group and is by no means limited to ISPs. If an ILEC end user customer initiates a call to an ISP, and that ISP is a subscriber to the ILEC's local exchange service, the ILEC will incur a cost to deliver that call to the ISP. If, however, the ISP subscribes to the local exchange service of a CLC (and calls to ISPs have been arbitrarily excluded from the reciprocal compensation mechanism), the ILEC will incur no costs associated with delivery of the call. As a result, the ILEC can be

expected to have little desire to attract and serve ISPs. Equally importantly, a CLC in this scenario will have incurred the costs of receiving and delivering the call, but will receive no compensation. CLCs, too will face a disincentive to serve ISPs. This problem, of course, is potentially much broader: each category of end users that the ILEC is successful in excluding from the reciprocal compensation mechanism will be effectively excluded from the benefits of a competitive market for local exchange services.

As a result, any attempt by the ILECs to exclude certain customer groups from reciprocal compensation will, if successful, have two negative impacts for Californians. First, the excluded customer groups will no longer benefit from the attention of competing carriers. Second, as high volume customers are taken away, CLCs will face additional and unnecessary challenges to their efforts to attract capital for investment and to reduce their per-unit costs. If this happens, even those customer groups that are not excluded from the reciprocal compensation mechanism will have fewer competitive alternatives.

Maintaining the existing reciprocal compensation mechanism will also provide the ILECs with continued incentives to invest in the facilities necessary to make alternative (non-switched) forms of Internet access, such as xDSL services, available. In addition, the ILECs will retain the incentive to reduce their network costs and to reflect those cost reductions in the rate for UNEs, including the UNEs that form the basis for reciprocal compensation rates.

Q. WILL ALTERNATIVE COMPENSATION ARRANGEMENTS RESULT IN THESE SAME COMPETITIVE AND FINANCIAL OUTCOMES?

A. No. A reciprocal compensation mechanism that (1) is applied to all calls, without regard to non cost-based customer distinctions, and (2) consists of rates based on the ILEC's TELRIC, is the only mechanism that can be expected to result in the benefits of local exchange competition being extended to ISPs and their customers. In addition, the failure to apply such a reciprocal compensation mechanism will result in the inability of CLCs to recover their costs, attract capital investment, and lower their per-unit cost of providing service to all of its customers. As a result, the competitive consequences of a failure to apply reciprocal compensation to ISP-bound calls would extend far beyond ISPs and their customers.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.